

## Table of contents



### **I. Key Events and Trends**

### **II. The Role of the Retail Sector in Russia**

### **III. Individual Segments of the Retail Sector**

*FMCG*

*Clothing & footwear and sporting goods*

*Automobiles*

*DIY, Household & Furniture*

*Pharmaceuticals*

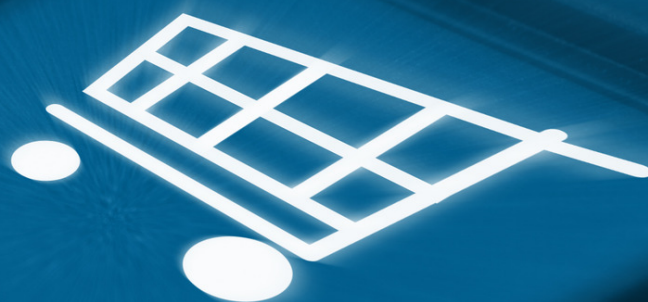
*Home appliance and consumer electronics*

*Children's goods*

*Online retail*

### **IV. The Consumer Goods and Trade Sector's Stock Market Performance**

# NRA latest retail report June 2016



## I. Key Events and Trends

- In 2015, the retail sector was on a growth path, which, however, was due to inflation; physical retail sales dropped 10 percent. Food prices increased by as much as 20 percent.
- The contraction of household real disposable income, combined with fast-growing consumer prices, brought about shifts in buying behaviors towards discretionary spending, while top consumer goods retailers continued to expand their retail networks. The poor penetration of modern trade formats remains the growth driver for the sector as a whole.
- The ruble depreciation in 2015 lifted prices for imported apparel and footwear, but drove down the business marginality and made some retailers in Russia decide to either scale down their networks or exit the market. At the same time, the favourable commercial property market environment opened the door for new premium and medium range brands to enter the market, and, hence, no clear downward trend in the market was observed.
- The Russian automotive market saw the sharpest fall of sales in 2015, with car sales going down to the 2009-10 crisis levels. In this situation, continued state support of the automotive industry is an important signal to the market.
- The year proved to be quite a boost for manufacturers of household appliances and home repair products. In spite of the negative economic environment, key players kept expanding their presence in Russia, in line with their strategic plan, announced as far back as 2014. Continued and slightly accelerated growth of new residential construction was an encouraging signal.
- In the pharmacy industry, the consolidation and organic growth processes are going on. In crisis times, pharmacies found it effective to scale down their medication offerings, particularly those of imported drugs and expand the offering of their branded products, as well as parapharmaceutical products.
- In the home appliance and consumer electronics markets, key players posted profit growth, despite the generally negative market trends. Growth was driven by flexible pricing strategies, diversification through trade in new categories of goods, and the effective use of offline and online marketing channels.
- The market for children's goods proved resilient to the macroeconomic turbulence. Upward dynamics was maintained due to a reduced share of the unorganized retail sector and a better demographic situation. Going forward, the decreasing number of reproductive-age women will affect the structure of consumer demand in this market.
- The e-trade sector faces strong competitive pressure from foreign internet businesses. Cross-border trade is growing faster than domestic sales, which gives rise to protectionist tendencies.

- In 2015, best performing industries in CJSC MICEX Stock Exchange were the consumer goods and trade sectors, which also outperformed other industries and the market in general.

## II. The Role of the Retail Sector in Russia

The trade sector<sup>1</sup> generates 15.8 percent of Russia's GDP, outperforming in this respect the manufacturing industry (14.1 percent) and the mining industry (9.8 percent)<sup>2</sup> The trade sector also provides the most jobs (18.7 percent, or 12.7 million people)<sup>3</sup> axes from the retail sector account for 2.8 percent of the federal government's total revenue (RUB 354.6 bn), or 10.6 percent, if wholesale operations and automotive sales are taken into account.<sup>4</sup> For comparison, the mining sector and the manufacturing industries account for 29.9% and 18.1 percent respectively of the federal government's total tax revenues.

### ***Retail sales in constant prices fell 10 percent in 2015***

The retail sector 2015 development trend can be defined as an inflation-driven growth. Retail sales in current prices increased 4.6 percent to RUB 27,575.7 bn, but in constant prices there was a 10 percent decrease<sup>5</sup>. In terms of product mix, the turnover changed little in 2015 and split almost equally between food (48.4 percent) and nonfood (51.4 percent).

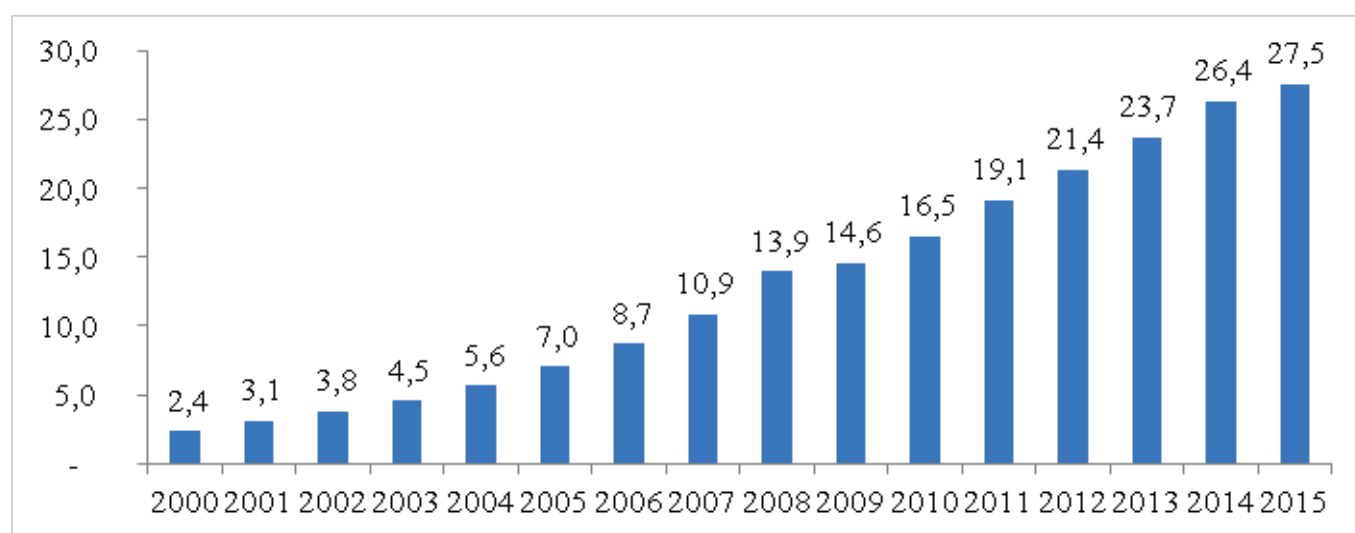


Fig. 1. – Retail sales in Russia, 2000 – 2015, trillion of rubles. Source: Russian FSSS

<sup>1</sup> Corresponds to Section G of OKVED (Russian Classification of Economic Activities) Russian FSSS (Federal State Statistics Service), Labor & Employment in Russia -2015 (collection of statistical data).

<sup>2</sup> Russian FSSS's data, GDP in current prices, [http://www.gks.ru/bgd/free/bo4\\_03/Isswww.exe/Stg/do6/64.htm](http://www.gks.ru/bgd/free/bo4_03/Isswww.exe/Stg/do6/64.htm)

<sup>3</sup> Corresponds to Section G of OKVED

<sup>4</sup> Russian FSSS's latest available data for 2014. "Tax revenues of the Russia's consolidated budget, broken down by types of economic activities.

<sup>5</sup> Russian FSSS's data, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/enterprise/retail/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/enterprise/retail/#)

## ***Russian consumer market took a big step back in the Global Retail Development Index, where it ranked 21st in 2015***

Russia fell nine places to 21st in A.T. Kearney's Global Retail Development Index™ (GRDI) in 2015 compared to 2014, which was due to a combined effect of macroeconomic, geo-political and fiscal risks and challenges, including the low oil prices, accelerated inflation, capital outflow, weakened consumer sentiment, economic slowdown, sanctions and import restrictions. The ruble devaluation affected the profit margins of businesses that have high share of imports in their cost structure<sup>6</sup> However, Russia's market is too big and too important to ignore (the Russian economy is the ninth largest in the world by population, and 10th largest by GDP)<sup>7</sup>.

## ***The share of imports in total retail sales fell to 38 percent, lowest since 2000***

In 2015, food and agricultural imports contracted 35.6 percent to US\$ 10.2 bn. Textile, apparel and footwear imports decreased 33.4 percent to US\$ 10.2 bn.<sup>8</sup> As a result, the share of imports in total retail sales fell to 38 percent, its lowest since 2000. Domestic production increased, according to Russian year-end inventory data, with beef production up 0.1 percent, and cheese production up 23.8 percent<sup>9</sup>. The producers of vegetable oils, powder milk and cream still have to rely on imported raw materials.

In 2015, the trade sector<sup>10</sup> performance improved in terms of the bottom-line result:<sup>11</sup> , with surplus increasing 51.6 percent, generally in line with the economy as a whole ( +53.1 percent). But the percentage of profit-making retailers remained practically unchanged – 80.4 percent (+0.3p.s. YOY), which, however, outperformed the economy as a whole (71.9 percent).

Leading Economic indicators for 4Q2015 attested that the retail business environment had significantly worsened.

## ***The Business Sentiment Index<sup>12</sup> declined to negative figures that were worse than during the crisis of 2008-2010***

<sup>6</sup> A.T. Kearney, 2015 Global Retail Development Index <https://www.atkearney.com/documents/10192/5972342/Global+Retail+Expansion-An+Unstoppable+Force++2015+GRDI.pdf/22c67371-43ec-4c27-b130-5c7c63c296fc> (p. 20)

<sup>7</sup> World Bank's latest available data on GDP in current USD (2014)

<sup>8</sup> UNECE (United Nations Economic Commission for Europe), statistical data on international trade, imports volumes in USD

<sup>9</sup> Russian FSSS's latest available data for Jan –Sep 2015, as compared to Jan –Sep 2014, inventory balances for individual goods for Jan –Sep 2015, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/publications/catalog/doc\\_1264687799516](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/publications/catalog/doc_1264687799516)

<sup>10</sup> Corresponds to Section G of OKVED, [http://www.gks.ru/bgd/free/b04\\_03/Isswww.exe/Stg/do6/42.htm](http://www.gks.ru/bgd/free/b04_03/Isswww.exe/Stg/do6/42.htm)

<sup>11</sup> Sectoral profit minus sectoral loss

<sup>12</sup> The Consumer Confidence Index in retail is an arithmetic mean value of evaluation balances for: (1) the level of storage stock (with the reverse sign), (2) changes in economic situation during current quarter as compared with previous quarter, and (3) expected changes in economic situation during the coming quarter, in percentage points.



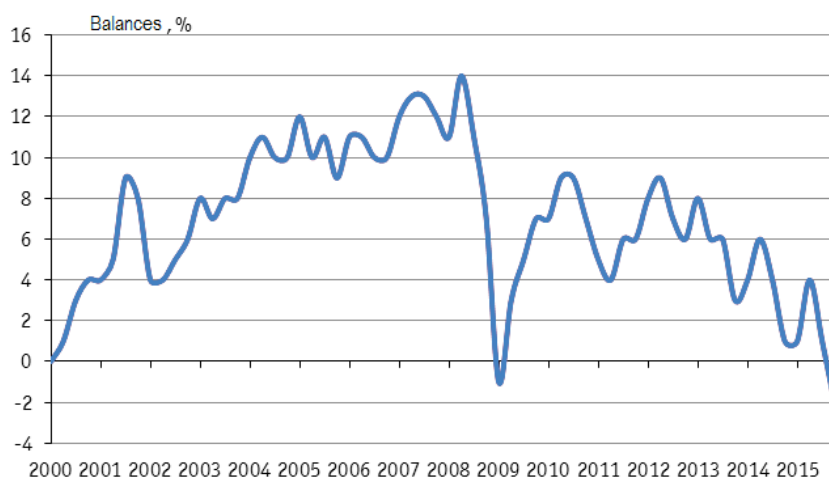


Fig. 2 - The Business Sentiment Index dynamics in retail. Source: NRU-HSE<sup>13</sup>

Factors that influenced the performance of Russian retail companies in 2015 included a year-on-year decline in disposable income, shortage of funds and constrained access to debt markets.

***Compared with the crisis in 2009, the 2015 situation was different in that there was no consumer support, according to Russian retail companies.***

Many Russians restrained from purchasing certain goods or bought them less often, demonstrating money-saving behavior<sup>14</sup> due to deflationary and inflationary expectations, falling real incomes and high household credit burden a narrow range of available loan products and the economic uncertainty. All this makes the retail companies move from strategic to short-term planning (with the planning horizon within three months) or the “manual control” aimed first of all at their business preservation.<sup>15</sup>

At the same time, the household credit burden began to show first signs of alleviation, as the Credit Health Index started to improve by year-end 2015 for the first time since 2012, when it reached its highest point. This is an important development, signaling consumer demand in Russia’s economy is stabilizing (see the figure below).

<sup>13</sup> National Research University Higher School of Economics (NRU – HSE), <https://iq.hse.ru/news/177663858.html>

<sup>14</sup> In 2015, retail deposits grew 24.5 percent to RUB 23.3 trillion, [http://www.eurasiancommission.org/ru/act/integr\\_i\\_makroec/dep\\_stat/finstat/Pages/denez-credit.aspx](http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_stat/finstat/Pages/denez-credit.aspx)

<sup>15</sup> NRU HSE, market Analysis • Retail Business Environment in the 4th quarter of 2015, p. 11

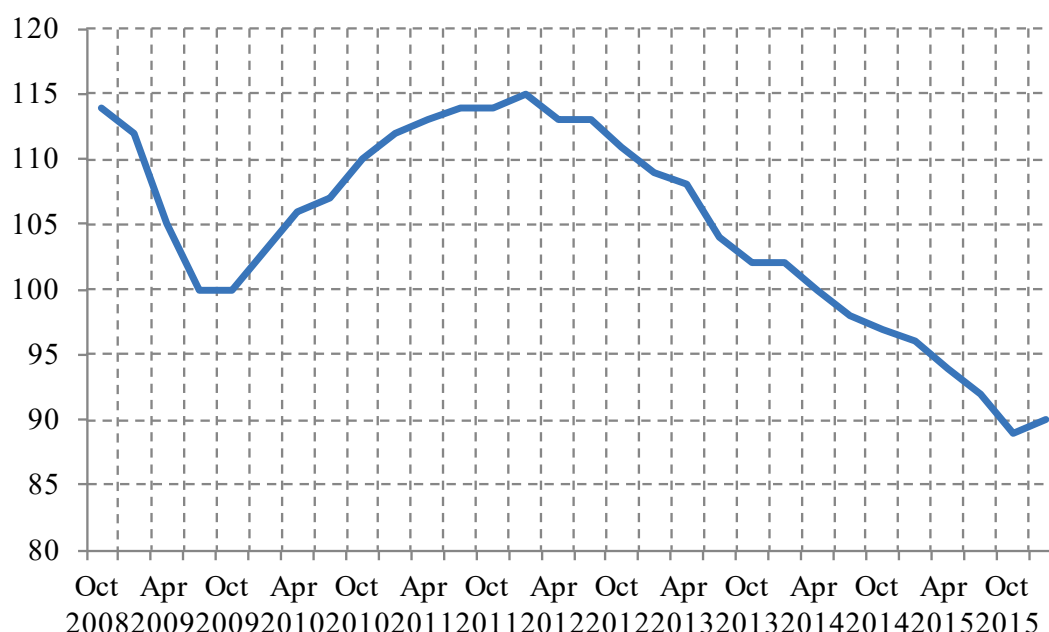


Fig. 3. FICO® Credit Health Index<sup>16</sup>. Source: The National Bureau of Credit Histories (NBKI)

Other 2015 trends worth noting are the intensification of the layoff process in the economy (the number of registered unemployed people increased in 2010-14 and reached 911.100 in 2015<sup>17</sup>), the increase in inventories, contraction of the range of goods due to a limited import substitution effect. All this indicates that the macroeconomic situation is worsening.

## III. Individual Segments of the Retail Sector

### FMCG

Fast-moving consumer goods (FMCG<sup>18</sup>) account for almost one-half (48 percent, or RUB 12.6 trillion<sup>19</sup>) of Russia's total retail sales.

In 2015, this market segment was influenced by tough macroeconomic conditions. The price dynamics is one of the most serious issues. 2015 saw an increase in the inflation rate Russia, with CPI up 119.1 percent YoY (111.4 percent in 2014). The inflation was mostly driven by raising food prices, that increased 119.1 percent, greater than nonfood 114.2 percent.<sup>20</sup>

<sup>16</sup> The FICO Credit Health Index measures the overall credit health of the country, based on the percentage of consumer loans and credit cards reported to NBKI that are delinquent by more than 60 days during the past 6 months (the "bad rate"). The index decrease or increase by 20 points means that the bad rate has doubled or declined two times respectively, <http://www.nbki.ru/company/news/?id=11988&print=yes>

<sup>17</sup> UNECE, socio-economics statistics, [http://www.eurasiancommission.org/ru/act/integr\\_i\\_makroec/dep\\_stat/econstat/Pages/labor\\_market.aspx](http://www.eurasiancommission.org/ru/act/integr_i_makroec/dep_stat/econstat/Pages/labor_market.aspx)

<sup>18</sup> Fast-moving consumer goods (FMCG) include processed foods, synthetic cleansing products and detergents, toiletries, household laundry soaps and other consumables.

<sup>19</sup> Russian FSSS's latest available data for 2014

<sup>20</sup> Russian FSSS, [http://www.gks.ru/bgd/free/Bo9\\_03/IssWWW.exe/Stg/do6/1.htm](http://www.gks.ru/bgd/free/Bo9_03/IssWWW.exe/Stg/do6/1.htm) (Cf. In 2014, CPI for food and non-food products was 115.4 and 111.4 percent respectively).

***Food items comprise 30.9 percent of total consumer spendings in Russia<sup>21</sup> compared to 6-12 percent in the developed countries.***

In 2015, the share of food and soft drinks increased 3.1 p.p. compared with 2014<sup>22</sup>. As a result, one-third of an average Russian person's budget grew 20 percent in the course of just one year.

There are a number of statistics that indicate that the financial position of Russian households has worsened, affecting the consumer activity and the general retail market conditions. For example, the disposable income<sup>23</sup> declined for the second year in a row (by 99.3 percent in 2014, by 95.7 percent in 2015).<sup>24</sup>

***As Russia's food inflation reached 19.1 percent, Russians saw their real wages increase by 4.8 percent (to RUB 33 981),<sup>25</sup> which affects their purchasing power and the consumption structure.***

In addition, wage arrears increased 1.8 times to RUB 3.6 bn in 2015<sup>26</sup>, driving down the cash income of households. According to available banking statistics, non-performing retail loans (overdue by 90 days) increased to RUB 1,084.3 bn from RUB 865.2 bn in the beginning of 2015 (comprising 10.5 and 7.0 percent of total loans respectively).<sup>27</sup>

***As a result of economic hardships, the estimated number of Russians living below the subsistence poverty increased to 19.2 million (13.4 percent of total population) from 16.1 million in 2014.<sup>28</sup>***

In 2015, Russia continued to ban food imports from the EU, the U.S., Australia, Canada and Norway.<sup>29</sup> In addition, the Russian President's Decree on Measures Providing the National Security of the Russian Federation and the Protection of its Citizens against Criminal and Other Unlawful Acts, and on Imposing Special Economic Measures in relation to the Republic of Turkey, dated Nov. 28, 2015, banned the imports of certain food items from Turkey. The list of banned food items included meat and dairy products, fish, vegetables and fruits, nuts and other products.

<sup>21</sup> Russian FSSS's 'Russia in Figures-2015' collection of statistical data. latest available data for 2014 (data for alcoholic drinks and tobacco not included), [http://www.gks.ru/bgd/regl/b15\\_11/IssWWW.exe/Stg/d01/07-12.htm](http://www.gks.ru/bgd/regl/b15_11/IssWWW.exe/Stg/d01/07-12.htm)

<sup>22</sup> Russian FSSS's data for 4Q2015, compared with 4Q 2014. [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/publications/catalog/doc\\_1140096812812](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/publications/catalog/doc_1140096812812)

<sup>23</sup> Income minus taxes and levies, adjusted for the CPI

<sup>24</sup> Russian FSSS's data, compared with the previous period

<sup>25</sup> Russian FSSS's data on monthly average calculated wages

<sup>26</sup> Russian FSSS's data on wage arrears (for Jan 1, 2015 – Jan 1, 2016)

<sup>27</sup> Central Bank of the Russian Federation (CBR), [http://www.cbr.ru/statistics/print.aspx?file=bank\\_system/risk\\_15.htm&pid=pdko\\_sub&sid=ITM\\_60627](http://www.cbr.ru/statistics/print.aspx?file=bank_system/risk_15.htm&pid=pdko_sub&sid=ITM_60627)

<sup>28</sup> Russian FSSS, [http://www.gks.ru/bgd/free/Bo4\\_03/IssWWW.exe/Stg/d06/53.htm](http://www.gks.ru/bgd/free/Bo4_03/IssWWW.exe/Stg/d06/53.htm) (the Republic of Crimea and Sevastopol not included)

<sup>29</sup> Presidential Decree of the Russian Federation dated June 24, 2015 'On the Prolongation of Some Special Economic Measures to Protect the Russian Federation's Safety', and Presidential Decree of the Russian Federation dated Aug. 6, 2014 'On the Implementation of Some Special Economic Measures to Protect the Russian Federation's Safety';

The poor penetration of modern format stores remains the growth driver for the sector as a whole.

***The contribution of retail chains in total retail sales grew consistently, from 17.5 percent in 2010 to 25.0 percent in 2015 (+2.1 p.p. compared with 2014)<sup>30</sup>***

However, modern grocery formats, such as the general-merchandise discount store, the supermarket, and the hypermarket currently comprise just around 65 percent of the total market.<sup>31</sup> Traditional retail outlets, open air markets and hawkers account for the rest of the market. To reach the developed countries' modern trade format market penetration level of 80.7-88.7 percent, Russia has a long way to go (more than 20 p.p.). Factors hindering the retail chains' geographic expansion include Russia's poor infrastructure, constraining the transportation of goods and affecting profit margins.

Despite the challenging macroeconomic environment and sluggish consumer activity, key market players have improved their financial and operating performance.

In the next 12 months, retail demand is expected to stabilize due to a decreasing demand in other markets and continued expansion of country-wide retail chains.

## Clothing & footwear and sporting goods

Sales of clothing & footwear and sporting goods make the second largest segment of the Russian retail market, accounting for almost one-fifth (18.2 percent) of the country's non-food retail turnover, and 9.6 percent of total retail turnover, or around RUB 2.5 trillion. Sales of clothing account for 11.3 percent of total consumer spendings.<sup>32</sup>

The ruble depreciation in 2015 lifted prices for imported goods, but drove down the business marginality and made some retailers in Russia decide to either scale down their networks or exit the market. For instance, Maratex, operating under franchise agreements with Esprit, OVS and River Island, announced the closure of more than 60 outlets in Russia. Mexx of the \Netherlands went bankrupt at year-end 2014. Zara closed its flagman store in Tverskaya Street, Moscow as part of its rent price control program. Adidas announced the closure of 2—branded stores, despite plans to open 150 stores in 2014.

At the same time, new premium and medium range brands entered the Russian clothing & footwear market in 2015, including Tsumori Chisato of Japan, On&On

<sup>30</sup> Russian FSSS, [http://www.gks.ru/free\\_doc/new\\_site/business/torg/rozn/rozn26.xls/](http://www.gks.ru/free_doc/new_site/business/torg/rozn/rozn26.xls/)

<sup>31</sup> Estimate by Magnit PJSC with reference to Infoline

<sup>32</sup> Russian FSSS's data for 4Q 2015, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/publications/catalog/doc\\_1140096812812](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/publications/catalog/doc_1140096812812)



of South Korea, Rocco P. of Italy, Stella Sport of Germany and Domino Eight of Ukraine, challenging the theory that foreign companies clearly tend to curb their business in Russia and exit the market. Interestingly, the premium segment proved relatively resilient to currency fluctuations, as evidenced by the fact that Gucci had opened two new outlets.<sup>33</sup>

***Favorable commercial property market environment is one of the factors encouraging new players to enter the market. In 2015, rents fell by 20-30 percent.***

Commercial conditions, including lease terms, have become more flexible, for example, rent may now be calculated as a percentage of tenant's annual turnover. Some trade centers have high-quality floor areas available, allowing international brands to get their best retail space for startup businesses.

While in 2014 the key driver of the clothing market evolution was the ruble depreciation, affecting the import profitability, in 2015, the main market factor was the maintained money-saving consumer behavior pattern that translated into low consumer activity with associated reduced trade traffic. Firms with brand positioning and operational effectiveness problems suffered most.<sup>34</sup>

Next year, the combination of consumer demand stagnation and tougher competition for consumers are expected to make the market.

## Automobiles

The automobile market is the third largest segment of the Russian retail market accounting for 6 percent, or RUB 1.6 trillion of total retail turnover.<sup>35</sup> In 2015, the Russian automobile market became the fifth largest in Europe and the 12th largest in the world (compared to number three and number eight respectively a year earlier).<sup>36</sup> This step back was fostered by a sharp (35.7 percent YoY) decrease in the sales of new passenger cars and light commercial vehicles (to 1, 601,216 vehicles)<sup>37</sup> following a growth in the last months of 2014, driven by expectation of the ruble depreciation and resultant increase in demand for imported consumer durables. By year-end 2015, the market returned to the crisis 2009-10 minima (see fig. 4).

<sup>33</sup> A.T. Kearney, 2015 Global Retail Development Index <https://www.atkearney.com/documents/10192/5972342/Global+Retail+Expansion-An+Unstoppable+Force+-+2015+GRDI.pdf/22c67371-43ec-4c27-b130-5c7c63c296fc> (стр. 20)

<sup>34</sup> Magazin Magazinov commercial real estate consulting, <http://www.magazinmagazinov.ru/news/detail.php?ID=14182>

<sup>35</sup> Russian FSSS's latest available data for 2014, in actual prices

<sup>36</sup> Avtostat Analytical Agency, <https://www.autostat.ru/infographics/24664/>

<sup>37</sup> Association of European Businesses, [http://www.aebrus.ru/upload/iblock/9fd/rus\\_car-sales-in-december-2015.pdf](http://www.aebrus.ru/upload/iblock/9fd/rus_car-sales-in-december-2015.pdf)

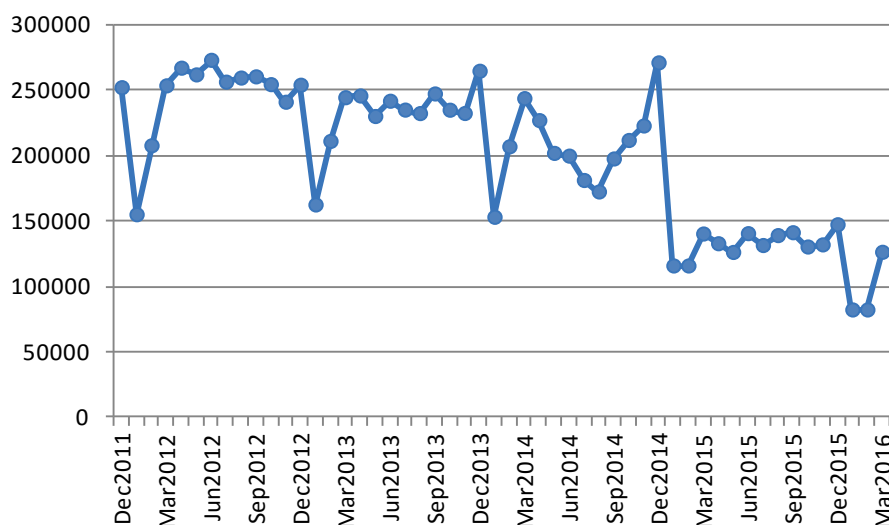


Fig. 4. Sales of new cars and commercial vehicles in Russia in 2007-15.

Sources: AutoBusinessReview B2B monthly, Association of European Businesses (AEB)

The sales of new cars and commercial vehicles in 2015 were influenced by the ruble depreciation and associated increase in automobile prices. The sales decreases were across the board during the year for all cars except the premium class PORSCHE, whose sales saw a 12 percent increase.<sup>38</sup> Russian UAZ (SOLLERS Group) sales were resilient to downturn, falling by just 2 percent. Among major automakers hit by large sales drops were Japan's HONDA Group (-75,4 percent), and France's PSA PEUGEOT CITROËN (-72,9 percent). Sales of Chinese cars dropped by 51.3 percent, bringing these cars' market share down to 2.4 percent by year-end 2015<sup>39</sup>. More than 60 percent of primary car sales were divided between four automakers: AvtoVAZ-Renault-Nissan (32.3 percent<sup>40</sup>), VW Group (10.3 percent), KIA (10.2 percent), and Hyundai (10.1 percent). The best selling cars were Lada Granta (120,200), Hyundai Solaris (115,900), and KIA New Rio (97,100). Sales through car dealers declined 34 percent to 924,000 passenger cars and light commercial vehicles<sup>41</sup>, with top 10 dealers accounting for one-third of total sales, or 350,400 automobiles, including 62,500 sold by Rolf, 43,500 by Major, 40,300 by TransTekhServis, 38,200 by Avtomir, 35,400 by Genser, 30,200 by AvtoSpetsTsentr, 27,900 by Agat, 25,500 by Favorit Motors, 23,500 by Samara-Auto, and 23,400 by KlyuchAuto. In addition to the sales decline, the market saw a shorter list of offered automobiles: 306 car models in 2015 versus 388 in 2014<sup>42</sup> as a result of

<sup>38</sup> Excluding carmakers selling less than 5,000 cars, AEB, [http://www.aeb.ru/upload/iblock/9fd/rus\\_car-sales-in-december-2015.pdf](http://www.aeb.ru/upload/iblock/9fd/rus_car-sales-in-december-2015.pdf)

<sup>39</sup> Data for Chinese carmakers CHERY, GEELY, LIFAN (- 80 percent of demand), as well as DFM, BRILLIANCE, CHANGAN, HAIMA, GREAT WALL, BAW, JAC, and FOTON

<sup>40</sup> Market share by new car sales volume, in natural terms

<sup>41</sup> AutoBusiness Review, data for 250 companies with sales larger than 1,000 cars, [http://abreview.ru/ab/news/troyka\\_kholdingov\\_demonstriruet\\_naimenshee\\_padenie/](http://abreview.ru/ab/news/troyka_kholdingov_demonstriruet_naimenshee_padenie/)

<sup>42</sup> AvtoSpetsTsentr Group, [http://www.ascgroup.ru/about/pressa/article\\_40613461.html](http://www.ascgroup.ru/about/pressa/article_40613461.html)

loss-making carmakers exiting Russia. The consumer demand continues to narrow down to two main market segments, low-budget B class vehicles, and SUV crossovers. GM's business in Russia was hit low profit margins resulting from the ruble fall and the low proportion of GM cars produced for the market locally, and had to be restructured.<sup>43</sup> In contrast, VW Group intends to continue its investment in Russia.<sup>44</sup>

***Continued state support of the automotive industry is a reassuring signal to the market. In 2015, the government allocated RUB 43 bn to stimulate auto sales; as result, around 1/3 of locally produced cars were purchased on favourable terms.***<sup>45</sup>

In 2016, the government will continue its efforts to provide a basis for the automotive industry recovery through exports stimulation and upgrading the domestic ambulance fleet, among other things. An allocation of RUB 50 bn to the industry is anticipated. This funding will include RUB 22.5 bn for the fleet updating (the Trade-In and Recycling Program). Rub 5 bn for leasing on favourable terms, and RUB 2.3 bn for auto lending on favourable terms.<sup>46</sup>

***Next year, Russian auto plants will continue to operate below their capacity; currently, they are running at 40 percent of their potential 3.4 million vehicles a year); overdue car loans have slowly risen to 8.5 percent at year-end 2015 from 6.7 percent in the beginning of the year.***<sup>47</sup>

Car makers expect that in the next two years, declining auto sales will be determining the market.

## DIY, Household & Furniture

The DIY<sup>48</sup>, Household & Furniture segment at RUB 1 trillion comprises 7 percent of the Russian nonfood retail sales<sup>49</sup>. The international relailer Leroy Merlin remains the biggest player in this market.

<sup>43</sup> Business mass media, <https://www.vedomosti.ru/business/articles/2015/09/07/607771-gm-ne-udaetsya-bez-konfliktov-uiti-iz-rossii>

<sup>44</sup> A.T. Kearney, 2015 Global Retail Development Index <https://www.atkearney.com/documents/10192/5972342/Global+Retail+Expansion-An+Unstoppable+Force+-+2015+GRDI.pdf/22c67371-43ec-4c27-b130-5c7c63c296fc> (p. 20)

<sup>45</sup> RF Government, <http://government.ru/news/21495/#doc2001>

<sup>46</sup> RF Government's Order # 71-p dated Jan. 23, 2016

<sup>47</sup> National Bureau of Credit Histories' data, relative to total loan portfolio (percent)

<sup>48</sup> Do It Yourself (DIY) refers to materials and equipment needed for building, repair and renovation without professional or expert aid

<sup>49</sup> Russia's FSSS, latest available data for 2014

Rank	Head equity	Brand	2015 sales (ex. VAT), bn rubles	2015/2014 change, percent
1	Leroy Merlin Vostok LLC (subsidiary of the France-based Groupe Adeo)	Leroy Merlin	143	20.6
2	OBI FC LLC (subsidiary of the Germany-based OBI GmbH & Co. Deutschland KG)	OBI	39	-10.2
3	Castorama Rus LLC (subsidiary of the UK-based Kingfisher)	Castorama	30.4	16.2
4	Petrovich House Construction Trade House LLC	Petrovich, Uroven	25.3	18.6
5	Saturn CJSC (Saturn Group)	SaturnStroyMarket	23.7	7.7

Fig. 5. Performance of largest DIY retailers in 2015, Source: INFOLine Information Agency<sup>50</sup>

The year proved to be constructive for DIY retailers operating in Russia:

***The largest DIY retailers opened 27 hypermarkets, of which eight, with total trading room floor area reaching a record 85,000 sq. m, were opened by Leroy Merlin. The total floor area of operational hypermarkets increased 8.3 percent (225,000 sq. m) to 2.7 million sq.m by year-end 2015.***<sup>51</sup>

By comparison, only 12 outlets with a total sales floor area of 48 sq. were closed. This means that despite the negative macroeconomic trends, the key players kept expanding their presence in Russia, in line with their strategic plans, announced as far back as 2014 (for example, Leroy Merlin launches 5-6 outlets (RUB 1 bn each) every year, and OBI is planning to open 18 outlets in Russia (investing a total of € 250 million) in the next three years.<sup>52</sup>

DIY players become increasingly interested in online retailing as a method for improving their operational effectiveness. For instance, the online channel accounted for 23 percent of total retail sales by Petrovich and 2 percent of Maxidom's total retail turnover(a 1.5x increase YoY) in 2015.<sup>53</sup>

Household demand for building materials, furniture and home appliances is directly linked to the construction sector performance. Maintenance and increase of the new construction building commissioning in 2015 was a reassuring signal for the DIY market players. The number of newly commissioned residential buildings increased to 286,100, with total floor area of 106.2 million sq.m, a new record for the past 16 years.<sup>54</sup>

<sup>50</sup> <http://infoline.spb.ru/diy-retailer-russia-top/index.php>

<sup>51</sup> Industry media with reference to INFOLine, [https://new-retail.ru/novosti/retail/diy\\_riteylery\\_narashchivayut\\_torgovye\\_ploshchadi\\_v\\_krizis8955/?sphrase\\_id=41184](https://new-retail.ru/novosti/retail/diy_riteylery_narashchivayut_torgovye_ploshchadi_v_krizis8955/?sphrase_id=41184)

<sup>52</sup> Business mass media with reference to Ian Strickland, OBI Russia's CEO, <http://www.kommersant.ru/doc/2625155>

<sup>53</sup> Industry media, [https://new-retail.ru/business/rynok\\_diy\\_v\\_krizis\\_perspektivy\\_dlya\\_regionalnykh\\_setey\\_8195/](https://new-retail.ru/business/rynok_diy_v_krizis_perspektivy_dlya_regionalnykh_setey_8195/)

<sup>54</sup> Russia's FSSS, data on new construction building commissioning, [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/enterprise/building/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/enterprise/building/#)



***One area of concern is a sharp deceleration of the new construction residential building commissioning rate: the year-on-year increase fell to 1.7 percent in 2015/2014 from 19.9 percent in 2014-2013.***

The construction sector is in a state of a sluggish recession, and no reversal can be expected without a fundamental improvement of the economic situation.<sup>55</sup>

The segment should be attractive to investors in the long term due to the housing stock becoming obsolete and owing to the construction sector's ambitious plans regarding both the quantitative (new construction building commissioning rate and reduction of construction costs per square) and qualitative (energy efficiency, environment friendliness) aspects.<sup>56</sup> Meanwhile, the expansion of big players will be gradually pushing weaker players away from the market.

## Pharmaceuticals

The pharmaceuticals market at around RUB 1 trillion accounts for 6.5 percent of the Russian nonfood retail sale. In 2015, it was estimated at RUB 1.3 trillion, a 9.3 percent increase YoY.<sup>57</sup>

Rank	Pharmacy chain	Market share, by retail sales, percent
1	The 36.6 and A.V.E merger.	5,8
2	Rigla	3,8
3	Raduga	2,7
4	Doctor Stoletov	2,5
5	Implosia	2,0
6	Pharmaimpeks	1,6
7	Pharmland	1,4
8	Other	80,2

Fig. 6. Leading retail pharmacy chains. Source: Protek Group with reference to IMS Group

***The retail sector is fragmented, with top five pharmacy chains accounting for 16.8. The situation is different in the drug manufacturing sector (top 5 players with a 24 percent market share) and distribution sector (64.2 percent).***<sup>58</sup>

OThe market continued to consolidate – through M&A and organically – in 2015. However, pharmacists dealing with vitally important drugs (VID) saw a reduction of their profit margin as a result of imported drugs price increase, and an increase in their fixed costs. On the other hand, top market players posted growing revenues.

<sup>55</sup> NRU-HSE, Market Research Center, The Construction Sector Business Environment, <https://iq.hse.ru/news/177663835.html>

<sup>56</sup> In accordance with the 'Affordable and Comfortable Housing Provision in Russia' government programme

<sup>57</sup> Protek Group with reference to DSM Group

<sup>58</sup> Protek Group, [http://www.protek-group.ru/upload/iblock/cf7/2015-protek-group-finance-results\\_-\\_eng\\_final\\_site.pdf](http://www.protek-group.ru/upload/iblock/cf7/2015-protek-group-finance-results_-_eng_final_site.pdf)

**According to official statistics, prices for pharmaceuticals increased 20.1 percent,<sup>59</sup> while prices for VID grew by 8.8 percent, and those for lowest-priced drugs, by 16 percent.<sup>60</sup>**

The VID low profit margins make drug manufacturers discontinue their production or export them to countries where prices are not regulated. Price increases for other pharmaceuticals are constrained by market factors, such as the growing number of low-income pharmacies, and general competition increase. Competitive advantages can be attained through an effective organic growth, the use of a multi-format store concept, as well as marketing involving supplier relationship management. In crisis times, pharmacies found it effective to scale down their medication offerings, particularly those of imported drugs and expand the offering of their branded products, as well as parapharmaceutical products (which generate higher margins), as well as manage the payment arrears risk more carefully.<sup>61</sup>

**In 2015, the imports of antibiotics and other drugs declined 32.5 percent to US\$ 7.0 bn.<sup>62</sup>**

The market participants find it difficult to make forecasts for the next two or three years.<sup>63</sup> At the same time, a major driver of investment, especially foreign one, in the Russian market is the idea of changing business cycles in emerging market economies, which should ultimately allow business growth rates better than in developed market economies.

## Home appliance and consumer electronics

According to Russia's FSSS, home appliance and consumer electronics (HACE) sales make the sixth largest segment of the Russian retail market, accounting for 2.8 percent of the country's total retail sales, and 5.46 percent of total nonfood retail turnover.<sup>64</sup>

In 2015m, the HACE market saw a 14 percent decline to RUB 1,268.5 bn,<sup>65</sup> which, however, was better than the market participants expected, considering the sharp drop in demand at year-end 2014.

**The market is well consolidated, with six top players (M.Video, Eldoprado, Svyaznoi< Media Markt, RTK, Yulmart) accounting for over one-half of total sale.<sup>66</sup> The consolidation continued in 2015.**

<sup>59</sup> Russia's FSSS, CPI goods and services by Individual Consumption according to Purpose (COICOP), [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/tariffs/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/tariffs/#)

<sup>60</sup> Business mass media with reference to Mikhail Murashko, head of Roszdravnadzor, [http://advis.ru/php/view\\_news.php?id=4986074F-0950-FA40-A81B-6D0C067B88D1](http://advis.ru/php/view_news.php?id=4986074F-0950-FA40-A81B-6D0C067B88D1)

<sup>61</sup> Business mass media, A. Filippov, Rigla CEO's interview, <http://www.rbc.ru/interview/business/11/10/2015/56155eb09a79472b4foaofa>

<sup>62</sup> Russia's Federal Customs Service, [http://www.customs.ru/index.php?option=com\\_content&view=article&id=22570:-----2015-&catid=53:2011-01-24-16-29-43](http://www.customs.ru/index.php?option=com_content&view=article&id=22570:-----2015-&catid=53:2011-01-24-16-29-43)

<sup>63</sup> <https://www.vedomosti.ru/business/characters/2015/12/01/619016-kompaniya-novoi-filosofiei>

<sup>64</sup> Latest available data for 2014.

<sup>65</sup> GfK's estimate, <http://temax.gfk.com/ru/RUB/storage/countries/ru/>

<sup>66</sup> SPARK Association of IT projects, data on retail sales of household electric appliances, radio and TV (70 percent of total data available; other data provided below) for 2014

In 2015, M. Video, the market leader, posted a 6.4 percent increase in consolidated profit (that reached RUB 190.8 bn).<sup>67</sup> The company also expanded its distribution network. The growth was driven by individual good categories (smartphones, in-ear headsets, smart gadgets, action cameras, etc.), consumer credit finance programmes (including interest-free allotment deals), as well as the use on online retail channels.

Eldorado, another top player, announced a record expansion in different areas of its business, including increased presence in small Russian towns (with population of around 50,000).<sup>68</sup> Growth was driven by flexible pricing strategies, the effective use of offline and online marketing channels, use of customer feedback strategies (best price offerings based on consumer sentiment monitoring results), and diversification through trade in new categories of goods (goods for children, their mothers, home and garden appliances). The bottom line is that HACE differs from other retail market segments in that it uses that multi category retailing in crisis times, while other segments have to narrow their lists of offerings.

Sales stabilization through the offering and service business components is expected to make the market in the next year.

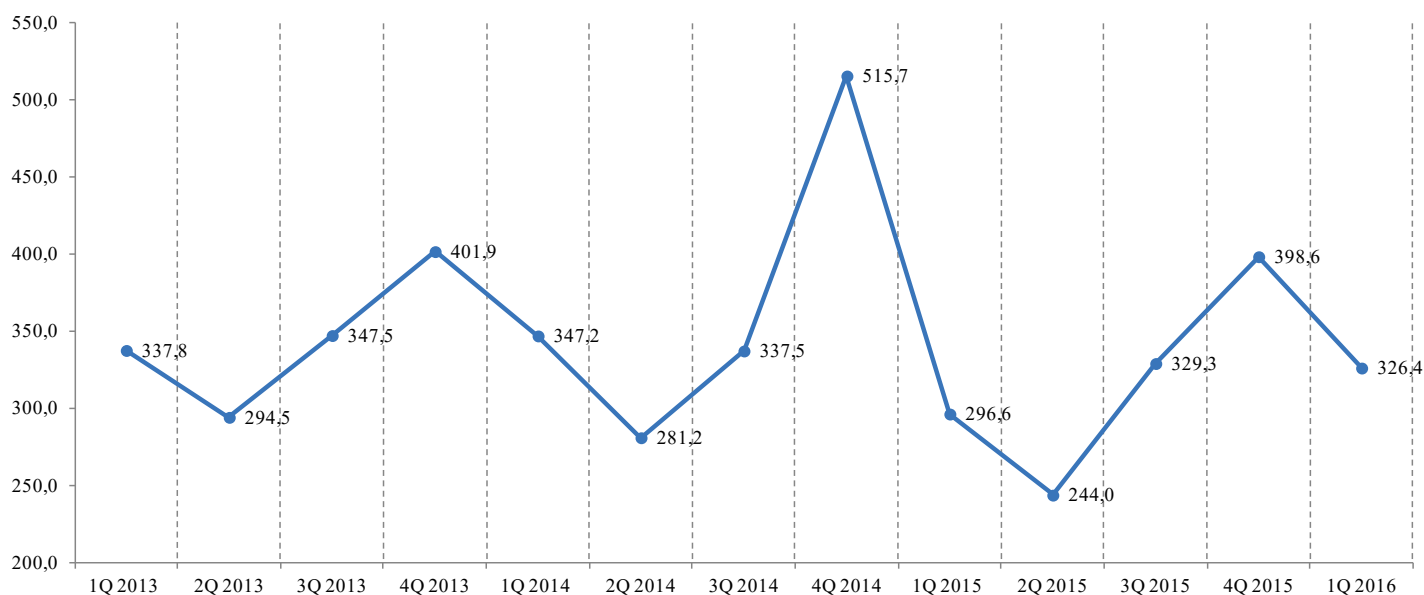


Fig. 7 –HACE retail turnover dynamics, bn rubles

Source: GfK

<sup>67</sup> Including VAT, according to consolidated IFRS audited financials for 2015.

<sup>68</sup> Eldorado, [http://www.eldorado.ru/research\\_center/article/detail.php?ID=383934656](http://www.eldorado.ru/research_center/article/detail.php?ID=383934656)

## Children's goods

The general distinguishing feature of the children's goods market is that it relies upon two consumer groups: children who initiate potential purchases and consumption, and adults who initiate and finance potential purchases. These features make the market relatively resilient to economic turmoils.

The Russian market in children's reached RUB 509 bn in 2015, with children's clothes accounting for around 30 percent, toys & games for 25 percent, and stuff for newly born babies for 24 percent.<sup>70</sup>

***The Russian children's goods market is import-reliant, with China, Poland, Finland and Germany as the main exporters, and domestically manufactured goods comprising about 20 percent of the average market volume (in value terms).***<sup>71</sup>

In 2015, the market dynamics was supported by the children goods' low "sensitivity" to economic hardships, reduced share of black-market and shadow-economy practices (sales through non-state channels) and a better demographic situation (the birth rate, i.e. the number of births per 1,000 population grew to 13.3 in 2014 from 8.7 in 2000, and infant mortality rate declined to 7.4 deaths per 1,000 live births in 2014 from 15.3 in 2000<sup>72</sup>) owing, among other things, to the government birth control policy в т.ч. за счет государственной политики в области рождаемости ('materinskii capital', a financial incentive for a parent with one or more children to give birth to or adopt another).<sup>73</sup> The market share of the 'unorganized retail' will be gradually substituted by state-owned distribution channels – this is why market players tended to consolidate their businesses and establish vertically integrated entities in the past few years. Sales remain strong through pharmacies, with this distribution segment enjoying a good consumer confidence figure, although the regulator has limited the list of goods that can be sold through pharmacies. Franchising and online-based distribution practices are on the rise.

At the same time, the children's goods market growth is constrained by a number of factors:

***The decreasing number of reproductive-age women<sup>74</sup>, which fell 10.6 percent to 35.7 million in 2002-15.***<sup>75</sup>

<sup>70</sup> Business media, [http://daily.rbc.ru/ins/own\\_business/18/08/2015/55d1ff479a7947e20ca83a34](http://daily.rbc.ru/ins/own_business/18/08/2015/55d1ff479a7947e20ca83a34)

<sup>71</sup> According to the Children's Goods Industry Development Strategy 2020 and the relevant Action Plan for 2013-15

<sup>72</sup> Russian FSSS's latest data available (as of May 25, 2016 natural population growth, [http://www.gks.ru/free\\_doc/new\\_site/population/demo/demo21.xls](http://www.gks.ru/free_doc/new_site/population/demo/demo21.xls); [http://www.gks.ru/free\\_doc/new\\_site/population/demo/demo22.xls](http://www.gks.ru/free_doc/new_site/population/demo/demo22.xls)

<sup>73</sup> GK Detskii Mir's factor estimate, [http://corp.detmir.ru/u/section\\_file/2364/qro415.pdf](http://corp.detmir.ru/u/section_file/2364/qro415.pdf) (стр. 29)

<sup>74</sup> 15-49 years

<sup>75</sup> Russian FSSS's data as of Jan. 1, 2016, segmentation by gender and age, [http://www.gks.ru/bgd/regl/B15\\_16/IssWWW.exe/Stg/1.5.xls](http://www.gks.ru/bgd/regl/B15_16/IssWWW.exe/Stg/1.5.xls)



This trend is likely to reduce the number of 0-3-year old children in the next 3-5 years and raise the importance of goods for 4-12-years old, affecting the stability of the sector's performance metrics. Indeed, goods for newborns (0-3 years old) are regarded as essential commodities that should be available in the market at any phase of the economic cycle.

Another area of concern is the disposable income decline<sup>76</sup>, bringing about shifts in buying behaviors during the crisis towards discretionary spending (consumers tend to buy cheaper items or have less items on their cheque lists), which strongly affects the toys and festive apparel market.

One positive development for the industry is the government support of this market, including a low (10 percent) VAT rate<sup>77</sup>, funding of domestic children's goods manufacturers under SME incentive-making regional programmes,<sup>78</sup> and the children's goods industry development state strategy.<sup>79</sup>

## Online retail

The amount of online retail sales in Russia grew 7 percent to RUB 760 bn in 2015. This was divided between domestic (71 percent) and cross-border online sales. Online sales are growing faster than the market average.<sup>80</sup> For instance, they increased 10.6x to RUB 220.4 bn in 2010-15, compared to an increase of 2.3x in domestic online sales for the same period. In the past few years, online sales have been changing geographically, with Chinese websites growing in importance. In 2015, the number of Russians purchasing goods through Chinese websites, increased 30 percent YoY and 2x in relation to 2013.<sup>81</sup> As a result, the amount of domestic purchases decreased 17 percent in 2015, while the number of parcels dispatched from abroad increased 75 percent.

Internet store	Monthly number of unique visitors, million.	Percent of the Internet users
Aliexpress.com	23 .8	39 .7
OZON.ru	9 .2	15 .3
Ebay.com	7 .4	12 .3
Mvideo.ru	7 .3	12 .2
Eldorado.ru	6 .2	10 .3
Wildberries.ru	6 .1	10 .2
Ulmart.ru	6 .1	10 .2
DNS-shop.ru	6 .0	10 .0
Lamoda.ru	5 .5	9 .2
Svyaznoy.ru	5 .4	9 .0

Fig. 08 –Leading Internet stores by number of visitors. Source:Internet retailers Association (IRA)

<sup>76</sup> Russian FSSS's complete data for 2014: household disposable income declined 99.3% vs. 2013, [http://www.gks.ru/free\\_doc/new\\_site/population/urov/urov\\_12kv.htm](http://www.gks.ru/free_doc/new_site/population/urov/urov_12kv.htm)

<sup>77</sup> Russian Government's Decree # 908 dated Dec. 31, 2004 On the List of Foodstuffs and Children's Goods, to be taxable at 10% VAT Rate»

<sup>78</sup> Karachay-Cherkess Republic, Amur, Voronezh, Kirov, Kursk, Kostroma, Lipetsk, Murmansk, Smolensk and Chelyabinsk Oblasts, and the City of St Petersburg

<sup>79</sup> Russian Government's Decree # 962-r dated June 11, 2013 (with edits as of Feb. 17, 2014)

<sup>80</sup> The IRA, e-commerce market data for 2015

<sup>81</sup> Yandex, [https://yandex.ru/company/researches/2015/ya\\_ecommerce](https://yandex.ru/company/researches/2015/ya_ecommerce)

Online trade is dominated by clothing & footwear and HACE. Most online buyers in Russia purchase small household appliances, clothing & footwear and cosmetics domestically, but buy abroad apparel & footwear, children's goods and mobile communication gadgets.<sup>82</sup>

Online sales of HACE grew 41 percent in 2014, but decreased 3 percent in 2015. Top HACE market players posted positive online sales results – for example, M. Video's sales grew more than 12 percent and reached 11 percent of total sales.<sup>83</sup> Svyaznoi increased the share of online sales to 25 percent of total sales in 2015<sup>84</sup>, which allowed the retailer to scale down its retail distribution network.

An encouraging signal for the industry is that in Russia, despite the country's high Internet penetration rate (70.4 percent in 2015<sup>85</sup>) the share of online trade in the retailers' total turnover remains low – less than 4 percent, that is, much lower than in other countries with high Internet penetration rates, where this share reaches 8.5 percent (Germany) and 13 percent (the UK<sup>86</sup>). This means that the growth potential is high enough. Another industry driver is the intense propagation of mobile devices (smartphones and tablets). For instance, M. Video, the top HACE market player, reports a 40 percent increase in purchases via mobile devices (38 percent of total Internet sales) in 2015.<sup>87</sup>

To control the expansion of foreign Internet retailers, the government is considering the proposals of recognizing foreign Internet retailers as Russian tax residents (the IRA's initiative) and reducing to € 22 the threshold below which import duty and taxes on goods bought by Russians through foreign Internet stores should be waived (Russia's Customs Service initiative).<sup>88</sup>

<sup>82</sup> Yandex, in cooperation with GfK, [https://yandex.ru/company/researches/2015/ya\\_ecommerce](https://yandex.ru/company/researches/2015/ya_ecommerce)

<sup>83</sup> Eldorado, excluding data on partners franchise, [http://www.eldorado.ru/research\\_center/article/detail.php?ID=38393465686](http://www.eldorado.ru/research_center/article/detail.php?ID=38393465686).

<sup>84</sup> Svyaznoi, <http://www.svyaznoy-group.ru/ru/news/-2015-2-800-/>

<sup>85</sup> GfK, <http://www.gfk.com/ru/insaity/press-release/issledovanie-gfk-za-2015-god-internet-auditorija-v-rossii-uvlechilas-eshche-na-4-mln-chelovek/>

<sup>86</sup> The IRA

<sup>87</sup> M.Video, 2015 Analytical Report

<sup>88</sup> The current threshold is € 1,000, or 21 kg for a calendar month. The proposal, submitted in several formats, was considered since 2014, but was vetoed in 2015 by Kazakhstan, the member of the Common Economic Territory. Business mass media, <http://www.vedomosti.ru/business/articles/2016/04/26/639230-porog-beshposhlinnogo-vvoza>

## IV. The Consumer Goods and Trade Sector's' Stock Market Performance

- Shares of the most liquid Consumer Goods and Trade (CGT) sector companies trading in CJSC MICEX Stock Exchange have been included in the industry MICEXCGS Index (RTS tghat has been calculated since 2005 and published since year-end 2009.
- The index is based on 11 companies. The calculation basis was repeatedly changed in 2015 due to Veropharm delisting in 1Q 2015 (following the company's takeover bt the U.S.-based Abbott<sup>89</sup>) the change in the Russkoe More Group's ticker to AQUA from RSEA on June 10, 2015 , the exclusion of Synergia PJSC and 36.6 Pharmacy Chain PJSC, the inclusion of AGRO PLS (ROS AGRO PLC), and Lenta Ltd. (Lenta Ltd.) depository notes, and Otisipharm PJSC shares. Still, the index remain relatively evenly distributed between the four key sectors – electronics and household appliances (27.9 percent), FMCG (26.7% percent, agriculture and aquaculture (26.6 percent), and pharmaceuticals industry(18.7%).
- ***The share of the pharmaceuticals industry in the index capitalization decreased 12.2 p.p., while the weghts of other index constituents increased.***
- Nevertheless, the MICEXCGS Index remains fairly representative of the constituent segments of the retail market. The index dynamics was positive in 2015, and in December (Dec. 1, 2015), the index reached a historical high off 6579.78 points. The 2014 maximum was 6,576 points While in 2014, the CGT sector performed worse than the consumer goods sector as a whole,
- ***In 2015, it became the best performing index in CJSC MICEX Stock Exchange, outperforming other industries and the market as a whole.***

<sup>89</sup> Veropharm's corporate website, <http://www.veropharm.ru/press/news/article.wbp?id=f02d499b-5bb0-467e-ae4d-7911ca8fc5a2>

## Index capitalization change in 2015 (US\$), %

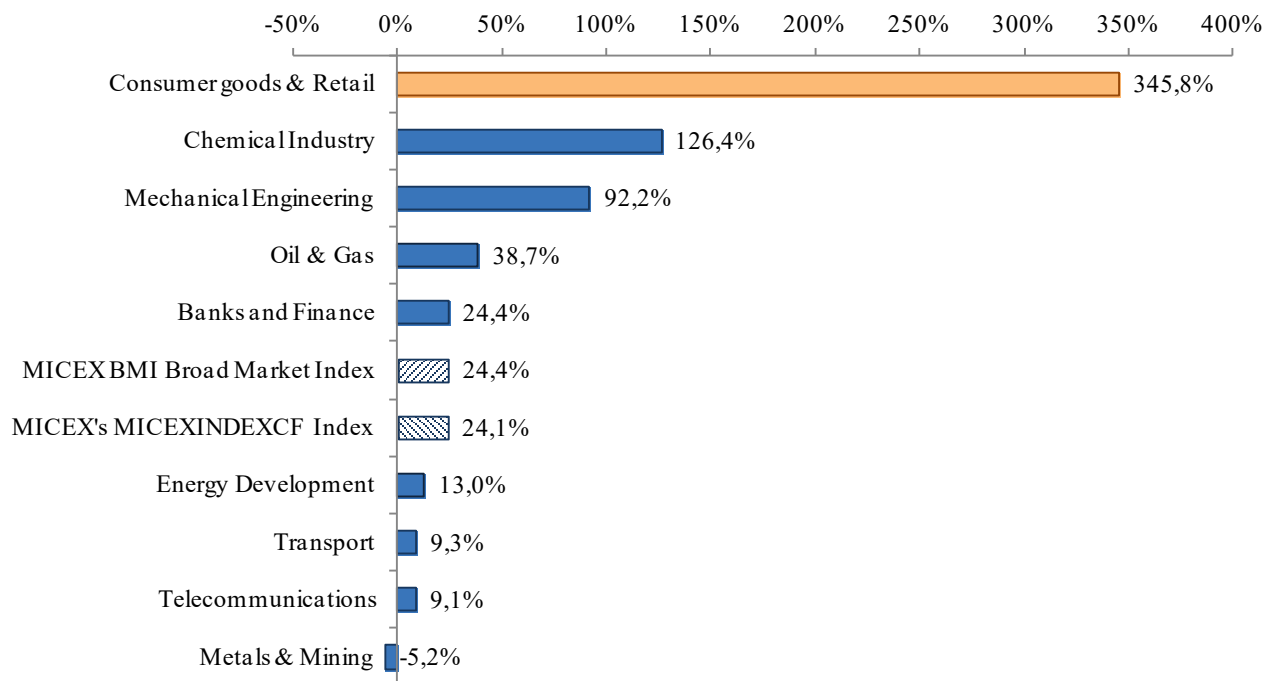


Fig. 9 –Changes in index capitalization in 2015 (rubles), change in percent. Source: the Moscow Exchange





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